



MULTISTATE TAX COMMISSION

Report to the
MTC Uniformity Committee on
Draft Amendments to the General
Allocation & Apportionment Regulations

Presented by Commission Staff

March 2, 2016

NOTICE

The information contained in these slides is intended to assist the Uniformity Committee and the states in considering draft amendments to MTC general allocation and apportionment regulations. The information is not intended to be used as “legislative history” when interpreting MTC models which may be adopted, in whole or in part, by the states.

- **Compact Art. I** – The purposes of the compact are to:
 - Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment . . .
 - **Promote uniformity or compatibility in significant components of tax systems.**
 - Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.
 - Avoid duplicative taxation

- **Art. VII.1** - . . . the Commission may adopt uniform regulations for any phase of the administration of such [uniform or similar] law.

- **Art. VII.2** – Prior to the adoption of any regulation, the Commission shall: As provided by its bylaws, hold at least one public hearing . . .[and] afford all affected party States and subdivisions and interested persons an opportunity to submit relevant written data and views, which shall be fully considered by the Commission.

The MTC's Uniformity Process

- Hearing Process: The Commission, or the Executive Committee . . . May hold hearings . . . May appoint a hearing officer . . . Hearings shall be open to the public . . [and a hearing officer shall] submit to the Executive Committee a report which shall contain a synopsis of the hearing procedures, and a detailed recommendation for Commission action. The Executive Committee shall consider the report and may either direct further study and consideration of its subject matter or submit the report, with its own recommendation for action, to the Commission.
- Hearing Report: Any recommendation for action submitted by the Executive Committee to the Commission relating to uniform or compatible tax laws, regulations or administrative practices . . . shall be circulated to the members . . . to determine if the affected members will consider adoption of the recommendation within their respective jurisdictions. . . The results of the survey of the members shall be reported to the chairman . . . If a majority have agreed, the chairman shall direct the consideration of the item . . .

Commission Bylaw 7

This bylaw governs the
uniformity process.



Back in the days of
real uniformity . . .

(MTC Meeting, 1971)

MULTISTATE TAXATION

MULTISTATE TAX COMMISSION

APPORTIONMENT REGULATIONS ADOPTED UNDER
ARTICLE IV OF COMPACT

(Uniform Division of Income for Tax Purposes Act)

The following regulations, indicated by a key symbol (O—), were adopted by the Multistate Tax Commission on September 10, 1971. They are subject to adoption by each member state in accordance with its own laws and procedures.

[¶ 6100] General.—The regulations numerical references are to Article IV of the Multistate Tax Compact and its subsections.

O— [¶ 6120] Reg. IV. 1. (a)(1). Business and Nonbusiness Income. Article IV. 1. (a) defines "business income" as income arising from transactions and activities in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, the business income of the taxpayer is that portion of the taxpayer's entire net income which arises from the conduct of the taxpayer's trade or business operations. For purposes of administration of Article IV, the income of the taxpayer is business income unless clearly classifiable as non-business income under Article IV. 4. to IV. 8. and the regulations thereunder.

Nonbusiness income means all income other than business income.

O— [¶ 6130] Reg. IV. 1. (a)(2) Business and Nonbusiness Income—Application of Definitions.—Article IV(1)(a) defines "business income." The term "business income" means income from any source arising from transactions and activities in the regular course of a trade or business. The critical element in the proper characterization of income as "business income" or "nonbusiness income" is identification of those activities and transactions which constitute the taxpayer's trade or business. In general, the activities and transactions of a taxpayer will be considered a "trade or business" if there is evidence to indicate that such activities and transactions were dependent upon or contributed to each other and to the operations of the taxpayer as a whole. The term "trade or business" is used in several sections of the Internal Revenue Code for federal income tax purposes, and this term, as used in Article IV(1)(a), in general, has the same meaning as when used in the Internal Revenue Code. For example, a particular activity will presumptively constitute part of a taxpayer's trade or business if the taxpayer, for federal income tax purposes, is able to deduct expenses incurred therein under § 162 of the Internal Revenue Code which provides for a deduction of certain "trade or business" expenses.

If the above standard is inconclusive, a determination of whether the activities and transactions of a taxpayer constitute a "trade or business" will turn on the facts of each case. There can be no ultimate definition of business income because the applicability of the term turns upon all the facts and circumstances pertaining to what constitutes the taxpayer's "trade or business."

.10 [Nonbusiness income.] In order for income from an activity and transaction to be classified as "nonbusiness income," it must be income arising out of

The original
"Miami" regulations

Adopted September 1971.

History of the General Allocation and Apportionment Regulations

- Originally adopted in 1971, the “Miami” regulations were very controversial.
- One major sticking point was exactly how broad the definition of “business income” was—and especially the treatment of dividend income.
- But there were other issues that divided even the states – including whether Sec. 17 should be applied “literally” given the results often generated.
- As a result of the substantial input before, during and after the hearing, the regulations were eventually repealed and substitute regulations were adopted in 1973.

*" . . . at the time of the Multistate Tax Commission's hearings on the . . . Proposed regulations, we find a very scholarly presentation by certain members of the business world calling our attention or reminding us that the original reason for the rules in the Uniform Act were to solidify or codify what then was the accepted law [with respect to allocated income items] . . . That was perhaps, pre-1957. Since that time, though, **I think we really have to take notice of what has happened in the world of taxation and the bringing of the tax administrators out of the morass of ignorance into a more enlightened viewpoint where they are beginning to realize perhaps what those old rules really meant . . .**"*

Comments of Ted deLooze,
Chief Tax Counsel, Oregon.
On panel with Jerome Hellerstein
before the MTC - speaking on
the "Miami" Regulations.
Dec. 1972

*"I guess the question that I have is what was served for breakfast that historic morning back in Miami Beach? As an individual who from industry has worked with Ted DeLooze's rules and regulations committee and in an attempt to hammer out some reasonable approach . . . I was very disappointed . . . And sincerely believe it was a step in the wrong direction. . . . I have considerable difficulty believing that all that language would be in there dealing with how certain types of income be treated when it is non-business income if we are to believe that substantially there is no such thing as non-business income. . . **I guess in conclusion, when you find out what was served for breakfast, I hope that you never serve it again.**"*

Comments of Dennis Tischler,
Mgr. Fed. & Internat'l Taxes, TRW
In Response to Ted deLooze on
the "Miami" Regulations.
Dec. 1972



- No Internet
- No online state laws/regulations
- No “state tax press”
- No cell phones
- No fax machines
- No conference calling (unless you count party-lines)
- No personal computers
- Little MTC staff support, and
- Very little if any experience with the issues under UDITPA

Other challenges
to the adoption
of the general
regulations

Report given by EDP
services representative
to the MTC Sept. 7, 1971
on Developments in Data
Processing.

staffing and programming the systems design but we took over the physical preparation of this 5,000 square foot facility. We worked with the electrical contractors and we brought in the air conditioning equipment. The people that we had doing the work had done it 5,6 or 10 times. We had a retired Colonel from SAC that had put in computers all over the world for the Air Force. We weren't hampered by bidding. We could negotiate. We built the site.

Indiana had attempted a CRT direct data entry system that had failed completely. At the time we took over, there were some 22 CRT units with nobody even operating them. There were about 30 keypunchers and verifiers. We have, as far as magnetic taping coders, overestimated the number we really need. We have 30 and right now are running them about 1/2 time. We are having to bring in work from other installations to keep these girls busy. We oriented the girls so that they could see what it was they were doing for a living. Up to this point, the computer had been on a completely separate floor and for all they knew they were sitting on a hammond organ. They can relate to the job and they can relate to the people who are running the computers. We also cleaned up their act in other ways. We took away Coke bottles and the sandwiches. These machines cost nearly \$8,000 apiece. If you spill a Coke into the keyboard, it takes about \$1,200 to get it back into operation again. We have the only time clock in the entire State Office Building. We installed a stroke counter on all of our equipment.

We were attacking what is nearly 50% of the total cost of automation in American industry today--that's input--equipment and people. That sector of the total tab is relevant every month because it's 4/5 personnel rather than equipment. Two days after the bid was awarded we had a luncheon

THE DRAFTING TEAM



Left to right: Lee Davis, Va.; Owen Clarke, Mass.; Robert Hynes, III.; Lou Del Duca, Pa.; and Bruce Hughes, Texas; produced "A Plan" which has received extensive consideration in recent Multistate Tax Commission meetings. Their product is believed to have broader state support than any other document yet proposed for the purpose of promoting uniformity, increasing state tax enforcement efficiency and decreasing business compliance burdens.

NOTICE OF PUBLIC HEARINGS

The Multistate Tax Commission will hold public hearings, pertaining to proposed Multistate Tax Commission regulations, beginning at 10:00 A.M. on April 26. The hearings will take place at the Radisson Hotel in Denver, Colorado.

Persons desiring to testify at these hearings should notify the Commission office not later than April 15. Written requests must be postmarked no later than midnight, April 15. Written presentation must also be postmarked no later than April 15 in order to be included in the record of the hearing.

The hearings will cover the following two agenda items:

1. Uniform Regulations with respect to substantive net income tax provisions in the Multistate Tax Compact, primarily Article IV.
2. An arbitration regulation which would deactivate the arbitration article (Article IX) for a period of at least two years, nullifying for that period previously adopted arbitration regulations.

Copies of the proposed regulations are available at the office of the Commission upon request.

Requests to testify must include:

1. A designation of the agenda item(s) to which the person testifying will address himself; and
2. An estimate of the amount of time requested for testimony on each agenda item.

The hearings will be conducted informally (without invoking rules of evidence, swearing of witnesses, etc.). To minimize inconvenience to persons attending and to assure orderly completion of the hearings:

1. Careful observance of time limits for each oral presentation will be necessary; and
2. Each person will make his presentation on any or all agenda items in a single appearance.

The hearings will continue as long as necessary after the April 26 date. Notice of the time schedule for oral presentations will be given, prior to April 19, to each person scheduled to testify.

Committee Reporters for each of the agenda items will be present in order to ask questions of, and to answer questions posed by, those making oral presentations.

In accordance with Section 7(e) of the Commission bylaws, the Hearing Officer will submit a report to the Commission containing:

1. A synopsis of the hearing proceedings;
2. A detailed recommendation for Commission action; and
3. A proposed draft for each of the regulations on the agenda.

The report is expected to be submitted to the Commission at its June 11 meeting in Seattle, Wash.

Appeared in the New York Times, the Wall Street Journal and other newspapers around the country.

Perspective - Uniformity Yesterday & Today

- The challenges faced by the drafters of the original regulations were, in many ways, greater than those we face today – despite the fact that they were seeking to interpret the same provisions of law (UDITPA) and not only because we have the assistance of technology – but because they were starting from scratch with little experience to guide them.
- In contrast, in the most recent process, we have had the benefit of assistance of states that have substantial experience with the issues and in drafting rules and we are fortunate to have had all the participants of that process and their contributions.

- Reg. IV.11.(a) and (b) were revised on July 14, 1988.
- Reg. IV.18.(c).4. was added on August 8, 1997.
- Reg. IV.2.(a).(5) was added on July 27, 2001.
- Reg. IV.1.(a) and (c) were revised on August 1, 2003.
- Reg. IV.2.(a).(4) was revised on August 1, 2003.
- Reg. IV.10.(b) was revised on August 1, 2003.
- Reg. IV.11.(b) was revised on August 1, 2003.
- Reg. IV.13.(a) was revised on August 1, 2003.
- Reg. IV.1.(b) was revised on January 15, 2004.
- Reg. IV.17.(2) and (3) were revised on August 2, 2007.
- Reg. IV.17.(4)(C) was added on August 2, 2007.
- Reg. IV.18.(a) was revised on July 29, 2010.

The General
Allocation and
Apportionment
Regulations
(revised 1973)
have been
amended
numerous
times.

- After the Uniform Law Commission (which had drafted UDITPA in 1957) abandoned its role in updating the model law, despite state movement away from and ongoing problems with certain provisions, the MTC began the revision process in 2009.
- In July 2014 and July 2015, the Commission approved recommended amendments to compact Article IV (UDITPA).
- Among other things, those recommended amendments changed the definitions of “business” and “nonbusiness” (now “apportionable” and “nonapportionable”) income, the definition of “receipts,” and changed how receipts from sale of services and intangibles are attributed to a particular state for receipts factor purposes.

Background

Benefits Received

- Looks to the place where the customer receives the primary value of the service or makes beneficial use of the intangible.
- Has a number of drawbacks
 - May often point to multiple locations
 - Requires information that only the customer may have
 - Subjective
- Puts additional pressure on the need for rules of approximation.

Delivery

- Like the rules for the sales of tangible property – looks primarily to the place where delivery occurs for services and, like the rules for lease of tangible property, to the place where the intangible property is used
- Drawback
 - Especially in B2B transactions involving services – there is a need to be careful to allow reasonable approximation of the delivery location but avoid abuse.

States have adopted different language which appears to embody two different theories.

Promoting Compatibility: Current Challenges (or Opportunities)

- Adoption of uniform recommendations by the Commission does not change the law or regulations in effect in any member state.
- Prior to and after the adoption of the amendments to Art. IV by the Commission, state law provisions varied.
- Commission's model regulations will implement the Art. IV amendments and follow the language of the amendments.
- States participating in the drafting process through the Uniformity Committee bring their own experience with their state's particular law as well as an understanding of the Commission's models to help develop uniform or compatible approaches.
- As a practical matter, states will need to determine how close their own statutes are to the Commission's recommended model and whether related model regulations can be adopted with or without modification.
- Staff of the Commission will, when possible, make available generally relevant drafting notes or other materials or information to assist states in evaluating proposed model regulations and integrating them into their law.

- Two work groups
 - Sec. 1 group – which made non-substantive conforming changes as well as changes needed to reflect the new definitions of “apportionable” (and “nonapportionable”) income and “receipts.”
 - Sec. 17 group – drafted new regulations to implement market-based sourcing (repealing the existing cost-of-performance rules).
- Status:
 - Started work in the late summer of 2014.
 - Completed their drafts and submitted them to the Uniformity Committee in December 2015.
 - Approved (with one minor amendment) by the Uniformity Committee and submitted to the Executive Committee.
 - Go to a public hearing on March 9, 2016.

Proposed Draft Amendments to the General Allocation and Apportionment Regulations



MULTISTATE TAX COMMISSION

*******NOTICE TO INTERESTED STATES AND MEMBERS OF THE PUBLIC*******
PUBLIC HEARING

Pursuant to the Multistate Tax Compact Art. VII.(2)(a) and Commission Bylaw 7(c), this is to notify you that the Commission will be holding a public hearing on proposed draft amendments to the Commission's Model General Allocation and Apportionment Regulations.

Date:	Wednesday, March 9, 2016
Time:	10:30AM Eastern
Location:	Hall of the States 444 North Capitol St., Room 231 Washington, DC 20002
Phone Access:	1-719-457-1414 Access Code – 258090#

A copy of those regulations with proposed amendments is available here in "clean" form:

<http://www.mtc.gov/getattachment/The-Commission/Committees/Executive-Committee/Executive-Committee-Meeting-1-2016/Draft-Amendments-to-Regulations-CLEAN-1-6-2016.pdf.aspx>

and here with changes shown in redline:

<http://www.mtc.gov/getattachment/The-Commission/Committees/Executive-Committee/Executive-Committee-Meeting-1-2016/Draft-Amendments-to-Regulations-REDLINE-1-6-2016-2.pdf.aspx>

Hearing Officer: Brian Hamer will preside as Hearing Officer. Brian was director of the Illinois Department of Revenue from 2003 to January 2015. Before that, he was deputy director of the Chicago Department of Revenue and chief assistant corporation counsel at the City's Department of Law. The Hearing Officer can be reached by calling Loretta King at the Multistate Tax Commission, 202-650-0300.

Submission of Comments: In addition to attending the hearing and giving comment, interested state representatives, taxpayers, practitioners and other members of the public are encouraged to submit relevant written data and views prior to or at the time of the hearing. Those comments may be submitted to lking@MTC.gov. Additional information on submission of comments may be provided in updates to this notice.

Draft Amendments
from the Section 1
(definitions)
Work Group

Original Provision

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

Amended Provision

(a) "Apportionable income" means:

(i) **all income that is apportionable under the Constitution** of the United States and is not allocated under the laws of this state, including:

(A) **income arising from transactions and activity in the regular course** of the taxpayer's trade or business, **and**

(B) income arising from tangible and intangible property if the acquisition, management, **employment, development** or disposition of the property **is or was related to the operation of the taxpayer's trade or business**; and

(ii) any income that would be allocable to this state under the Constitution of the United States, but that is apportioned rather than allocated pursuant to the laws of this state.

Section 1(a) – Before and After

Original Provision

g) "Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.

Amended Provision

(g) "Receipts" means all gross receipts of the taxpayer that are not allocated under paragraphs of this article, **and that are received from transactions and activity in the regular course of the taxpayer's trade or business; except that receipts of a taxpayer from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities, shall be excluded.**

Section 1(g) –
Before and After

Section 1 Draft Amendments to the Regulations

- Conformity to the language of the new definition of “apportionable” income and “receipts”
- Changes to reflect that “apportionable” income is now clearly broadened to the extent constitutionally allowed
- Changes to reflect the narrowing of the definition of receipts:
 - Only receipts that meet the transactional test
 - Receipts explicitly excluded
- Other changes needed to “clean up” sections of the existing regulations
- Deletion of Sec.18 regulations that appear no longer necessary

Draft Amendments
from the Section 17
(market-based sourcing)
Work Group

17. (a) . . . The taxpayer's market for sales is in this state: . . .

. . . (3) in the case of sale of a **service**, if and to the extent the service is **delivered to a location** in this state; and

(4) in the case of **intangible property**,

(i) **that is rented, leased, or licensed, if and to the extent the property is used in this state**, provided that intangible **property utilized in marketing** a good or service to a consumer is "**used in this state**" if that good or service is **purchased by a consumer who is in this state**; and

(ii) **that is sold, if and to the extent the property is used in this state**, provided that:

(A) **a contract right, . . . that authorizes the holder to conduct a business activity in a specific geographic area is "used in this state" if the geographic area includes all or part of this state**;

(B) receipts from intangible property sales that are contingent on the productivity, use, or disposition . . . shall be treated as receipts from the rental, lease or licensing of such intangible property under subsection (a)(4)(i); and

(C) **all other receipts from a sale of intangible property shall be excluded from the numerator and denominator** of the receipts factor.

(b) If the state or states of assignment under subsection (a) cannot be determined, the state or states of assignment **shall be reasonably approximated**.

(c) **If the taxpayer is not taxable in a state** to which a receipt is assigned . . . , **or if the state of assignment cannot be determined . . . or reasonably approximated . . . such receipt shall be excluded** from the denominator of the receipts factor.

(d) [The tax administrator may prescribe regulations as necessary . . .]

Section 17 – After

Simple Depiction of the New Market-Based Sourcing Rules

••• Reg. IV.17.(a). Receipts Factor: Sales Other Than Sales of Tangible Personal Property in This State: General Rules.

(1) Market-Based Sourcing.

(2) Outline of topics.

(3) Definitions.

(4) General Principles of Application; Contemporaneous Records.

(5) Rules of Reasonable Approximation.

(A) In General

(B) Approximation Based Upon Known Sales

(C) Related-Party Transactions – Information Imputed from Customer to Taxpayer

(6) Rules with Respect to Exclusion of Receipts from the Receipts Factor

(7) Changes in Methodology; [tax administrator] Review

(A) No Limitation on Article IV.18 or Reg. IV.18.

(B) General Rules Applicable to Original Returns.

(C) [Tax Administrator] Authority to Adjust a Taxpayer's Return.

(8) Further Guidance.

••• Reg. IV.17.(b). Sale, Rental, Lease or License of Real Property..

••• Reg. IV.17.(c). Rental, Lease or License of Tangible Personal Property.

Outline of Sec. 17

Available on the Sec. 17
project page along with other
information.

••• Reg. IV.17.(d). Sale of a Service.

(1) General Rule.

(2) In-Person Services.

(A) In General.

(B) Assignment of Receipts.

1. Rule of Determination.

(C) Rule of Reasonable Approximation.

(D) Examples.

Outline of Sec. 17

(3) Services Delivered to the Customer or on Behalf of the Customer, or Delivered Electronically Through the Customer.

(A) In General.

(B) Assignment of Receipts.

1. Delivery to or on Behalf of a Customer by Physical Means
Whether to an Individual or Business Customer

2. Delivery to a Customer by Electronic Transmission.

a. Services Delivered By Electronic Transmission to an Individual Customer.

b. Services Delivered By Electronic Transmission to a Business Customer.

3. Services Delivered Electronically Through or on Behalf of an Individual or Business Customer.

Outline of Sec. 17

(4) Professional Services.

(A) In General.

(B) Overlap with Other Categories of Services.

(C) Assignment of Receipts.

1. General Rule.

a. Professional Services Delivered to Individual Customers.

b. Professional Services Delivered to Business Customers.

c. Safe Harbor; Large Volume of Transactions.

2. Architectural and Engineering Services with respect to Real or Tangible Personal Property.

3. Services Provided by a Financial Institution.

4. Related Party Transactions.

5. Examples

Outline of Sec. 17

••• Reg. IV.17.(e). License or Lease of Intangible Property.

- (1) General Rules.
- (2) License of a Marketing Intangible.
- (3) License of a Production Intangible.
- (4) License of a Mixed Intangible.
- (5) License of Intangible Property where Substance of Transaction Resembles a Sale of Goods or Services.
 - (A) In general.
 - (B) Sublicenses.
 - (C) Examples

Outline of Sec. 17

••• Reg. IV.17.(f). Sale of Intangible Property.

(1) Assignment of Receipts.

(A) Contract Right or Government License that Authorizes Business Activity in Specific Geographic Area.

(B) Sale that Resembles a License (Receipts are Contingent on Productivity, Use or Disposition of the Intangible Property).

(C) Sale that Resembles a Sale of Goods and Services.

(D) Excluded Receipts.

(E) Examples.

••• Reg. IV.17.(g). Special Rules.

(1) Software Transactions.

(2) Sales or Licenses of Digital Goods or Services.

(A) In general.

(B) Telecommunications Companies

Outline of Sec. 17